STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION
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TO COUNTY ASSESSORS AND INTERESTED PARTIES:

DRAFT PAPER: "THE EFFECT OF INTANGIBLES ON PROPERTY VALUE"

Assessment Standards Division staff prepared and presented the enclosed paper to facilitate discussions at a hearing held by the Board's Property Tax Committee on January 7, 1992. At the request of the California Taxpayers' Association, the Board directed staff to distribute the paper to interested parties and solicit feedback on its content.

What changes would you suggest to improve the paper? Is there a need by taxpayers, assessment administrators, or property tax appraisers for a revised and Board-adopted position paper/Assessors' Handbook Section on this subject? Your timely comments will be considered as the Board continues to focus on proposed Rule 11, Intangibles, and related issues of concern to property taxpayers.

The enclosed paper is in draft format; it does not reflect the position of the Board Members. Please direct suggestions and comments to the Assessment Standards Division at your earliest convenience.

Sincerely,

Verne Walton

Verne Walton, Chief
Assessment Standards Division

VW:sk
Enclosure

NOTE: See Assessors' Handbook Section 502, *Advanced Appraisal*, Chapter 6, for current Board position.

THE EFFECT OF INTANGIBLES ON PROPERTY VALUE

(A draft paper prepared by the Assessment Standards Division for presentation to the California State Board of Equalization on January 7, 1992.)

FOREWORD

Background

All businesses have assets. In many cases, a business's most valuable assets are its items of tangible property, such as buildings, land, vehicles, and equipment. Often, however, a substantial portion of a business's assets are intangible. That is, many businesses are purchased not only for their tangible assets, but also for valuable intangible assets, such as customer lists, trade names, or copyrights.

As taxpayers, business owners have a financial interest in the tax treatment of both their tangible and intangible assets. For example, in figuring a business's income tax liability the taxpayer has an incentive to claim as many deductions as possible over the shortest time period. The Internal Revenue Code provides specific depreciation schedules for virtually all conceivable tangible assets; the costs of these assets are depreciated, over a period of years, thus reducing the business's taxable income.

With respect to intangible assets, the income tax law is much less specific than for tangible assets. Generally, the cost of an intangible asset can be amortized over the asset's useful life if the asset can be separately identified and valued and if its specific useful life can be determined. So-called goodwill and going concern values are deemed not to have these characteristics and are therefore not amortizable.

For intangible assets, taxpayers' determinations of useful lives are only questioned in an audit. Consequently taxpayers have an incentive to classify all of their intangible assets as something other than goodwill or going concern value; i.e., to attempt to separately identify and value their intangibles. The incentive to classify intangibles as amortizable assets became much more important during the 1980s as business acquisition activity increased.

Under California property tax law, real property is reappraised by the county assessor whenever the property undergoes a change in ownership. Under the change in ownership statutes, acquisition of one legal entity (e.g., corporation or partnership) by another constitutes a change in ownership of the acquired company's real property. A change in ownership also occurs when any individual or legal entity acquires a majority ownership interest in another legal entity owning real property. One can easily see that, as with the federal income tax, the increase in business acquisitions significantly impacted the acquired businesses' California real property taxes.

The Problem

Taxing agencies expect taxpayers to do whatever they can within the law to minimize their tax liability. This is obviously true whether the tax is according to their net income or the value of their property. The problem, and the reason for the discussion that follows, is that business owners seem to be lifting concepts they have devised to minimize their income tax liability and are inappropriately applying those same concepts in their arguments for lower California property tax liability.

Specifically, there seems to be a tenet among business owners that if they can argue successfully that a particular intangible is identifiable, then the presence of the intangible must be discounted in valuing the business's taxable property. Moreover, even if an intangible is not identifiable, these taxpayers seem to believe that in valuing their businesses in toto, anything above the replacement cost of their tangible assets represents value that may not be assessed for property tax purposes. That is, taxpayers seem to believe that any value beyond the replacement cost of their tangible property is attributable not to their property but rather to their enterprise activity.

Objectives

On the following pages we attempt to clarify, for California property tax purposes, the legal and valuational treatment of intangibles. We will show that under California law taxable property must be valued at its beneficial and productive use, and that the assessor must consider the presence of any intangible rights and privileges necessary to put the taxable property to beneficial and productive use.

Further, we will clarify that it is perfectly consistent, both legally and conceptually, to consider the presence of intangibles in valuing taxable property while at the same time exempting from property taxation the value of the intangibles themselves. Additionally, recognizing that value attributable to enterprise activity is not taxable, we will recommend factors to consider in determining whether the earnings of a business are dependent largely on enterprise activity, or if those same earnings are attributable to the taxable property used by the business.

INTRODUCTION

Where taxable property is used for business purposes, such as retailing, manufacturing, or professional services, disputes over the assessment of the property often arise between taxpayers and county assessors. Once in receipt of their notices of valuation from the assessor, these taxpayers often complain that the intangible value of their business is being improperly included with the value of their taxable property. While recognizing that such taxpayers have an economic incentive to argue for lower assessments, legitimate questions do nonetheless arise about the proper valuation of property used for business purposes.

For example, if real property occupied by a business is being appraised based on its ability to produce income, the question is, what portion of the total income generated by the business results from attributes of the real property? Similarly, if the basis of the appraisal is the purchase price of the assets of the business, including the taxable property, the question is, what portion of the total purchase price reflects fair consideration for the taxable property?

Stated in terms more positively related to the issue of assessing intangibles, the questions are, what portion of the total income of the business results from human enterprise activities, or what portion of the purchase price of the assets of the business results from the business's nontaxable intangible assets?

The purpose of the discussion on the following pages is to shed light on possible solutions to the above questions about intangible values and taxable property. To this end we will first establish the legal framework within which possible solutions must be analyzed. Second, we will recommend guidelines for solving problems involving the assessment of intangibles. Finally, as an appendix, we have summarized each of the relevant court decisions on the subject.

We do not include discussions of intangibles in specific valuation approaches. Our discussion of earnings would seem to imply a discussion of the income approach. However, the same principles apply to all valuation approaches. After all, the issue is not how a particular appraisal approach is to be calculated; the issue is whether the assessed value is the legally correct value for property tax purposes.

Note also that we embark upon this discussion with the aim of clarifying issues relating to locally-assessed property. Thus, we do not consider the treatment of special franchises or other state-assessed property, even though all of the appraisal concepts discussed would apply equally.

LEGISLATIVE AND JUDICIAL TREATMENT OF INTANGIBLES

Taxation of Intangible Personal Property

Article XIII of the California Constitution originally provided for a uniform property tax on both real and personal property. While all real property within the same taxing jurisdiction continues to be taxed at the same rate (if not under the same value standard), subsequent amendments to Article XIII authorized the Legislature to classify tangible personal property and certain intangible personal property for differential taxation or exemption.

Section 14 of Article XIII as amended in 1933 stated in part as follows:

> "The Legislature shall have the power to provide for the assessment, levy and collection of taxes upon all forms of tangible personal property, all notes, debentures, shares of capital stock, bonds, solvent credits, deeds of trust, mortgages, and any legal or equitable interest therein, not exempt from taxation under the provisions of this Constitution, in such manner, and at such rates, as may be provided by law, and in pursuance of the exercise of such power the Legislature, two-thirds of all of the members elected to each of the two houses voting in favor thereof, may classify any and all kinds of personal property for the purposes of assessment an taxation in a manner and at a rate or rates in proportion to value different from any other property in this State subject to taxation and may exempt entirely from taxation any or all forms, types or classes of personal property.
>
> "The total tax imposed on notes, debentures, shares of capital stock, bonds, solvent credits, deeds of trust, mortgages, and any legal or equitable interest therein in pursuance of the provisions of this section shall not be at a rate in excess of four-tenths of one per cent of the actual value of such property and no tax burden shall be imposed upon any personal property either tangible or intangible which shall exceed the tax burden on real property in the same taxing jurisdiction in proportion to the actual value of such property."

In 1974, Article XIII underwent a substantial revision such that, currently, the provisions of former section 14 are stated more succinctly and in a different location, section 2, which reads as follows:

> "The Legislature may provide for property taxation of all forms of tangible personal property, shares of capital stock, evidences of indebtedness, and any legal or equitable interests therein not exempt under any other provision of this article. The Legislature, two-thirds of the membership of each house concurring, may classify such personal property for differential taxation or for exemption. The tax on any interest in notes, debentures, shares of capital stock, bonds, solvent credits, deeds of trust, or mortgages shall not exceed four-tenths of one percent of full value, and the tax per dollar of full value shall not be higher on personal property than on real property in the same taxing jurisdiction."

The substantial similarity between the language of current section 2 and former section 14 is important to note because judicial construction of the constitutional provisions relating to taxation of intangible personal property was made largely prior to the 1974 revision. Specifically, the distinction in former section 14 between "all forms of tangible personal property" and "all notes, debentures, shares of capital stock, bonds, solvent credits, deeds of trust, mortgages, and any legal or equitable interest therein" was held to be indicative that the framers of the amendment were of the view that the intangibles listed covered all the forms of taxable intangible property, just as the phrase "all forms of tangible personal property" covered all forms of such property. Roehm v. County of Orange 32 Cal.2d 280 (1948)

Thus, the Roehm court indicated that the Legislature is not empowered to provide for taxation of any intangible assets other than those listed in section 2 (i.e., shares of capital stock, evidences of indebtedness, and any legal or equitable interests therein). Of those intangibles for which the Legislature may provide for taxation, Revenue and Taxation Code section 212 expressly exempts "[n]otes, debentures, shares of capital stock, solvent credits, bonds, deeds of trust, mortgages, and any interest in such property."

Additionally, in 1988 the Legislature enacted Revenue and Taxation Code section 107.7 relating to the valuation of cable television systems. This section provides for a preferred method of valuation of cable television possessory interests and states that intangible assets or rights of a cable television system are not subject to ad valorem property taxation. The section goes on to list numerous such intangible assets or rights.

To summarize the foregoing, the Legislature and the courts have made very clear the issue of taxation of intangible personal property. Simply, the constitution provides only a short list of intangibles from which the Legislature may choose to tax or not. Any intangibles not specified in that short list are nontaxable. And since the Legislature has expressly exempted all those intangibles listed, there are no items of intangible personal property which are separately taxed as property. The Legislature seemed to reinforce this conclusion when it enacted Revenue and Taxation Code section 107.7.

Valuation of Taxable Property Assuming the Presence of Intangibles

While clearly establishing that intangible personal property may not be separately taxed as property, the courts and the Legislature have been careful in recognizing the constitutional requirement that taxable property be assessed at its full value. (De Luz Homes, Inc. v. County of San Diego (1955) 45 Cal.2d 546) Specifically, the courts have held and the Legislature has recognized that to properly assess taxable property at its full value as required by the constitution, the assessor must value the property assuming the presence of whatever intangible assets are necessary to put the property to beneficial or productive use.

Thus, for example, a developer's interest in a parcel of vacant land might be worth little without the necessary permits to build. Although a building permit would be intangible personal property which is not taxable as property in and of itself, the assessor must consider the presence of the necessary permits in arriving at the full value of the developer's taxable property.

The most recent court decision on the subject of intangibles, County of Stanislaus v. Assessment Appeals Bd. 213 Cal.App.3d 1445 (1989), places these issues in legal perspective. The issue before the court was whether a cable television franchise is subject to real property tax. The court held that while the franchisee's right to charge a fee and to make a profit from the operation of the business is a constitutionally protected nontaxable asset, the assessor may take into consideration the presence of the franchise in valuing the taxable property of the cable system. Beginning at page 1454, the court explained:

"Our conclusion that the intangible right to do business is not assessable for ad valorem tax purposes, however, does not mean the value of Post-Newsweek's intangible rights may not be considered in assessing the value of the possessory interests. As explained by Justice Traynor in Roehm v. County of Orange, supra, 32 Cal.2d 280 at page 285, 'Intangible values . . . that cannot be separately taxed as property may be reflected in the valuation of taxable property. Thus, in determining the value of [taxable] property, assessing authorities may take into consideration earnings derived therefrom, which may depend upon the possession of intangible rights and privileges that are not themselves regarded as a separate class of taxable property.' (Italics added, accord Michael Todd Co. v. County of Los Angeles(1962) 57 Cal.2d 684, 693-694 [21 Cal.Rptr.604, 371 P.2d 340]; Western Title Guaranty Co. v. County of Stanislaus (1974) 41 Cal.App.3d 733, 741 [116 Cal.Rptr. 351].)

"In Western Title Guaranty Co., it is stated: '[T]he propriety of including nontaxable intangible values in the valuation of otherwise taxable property has been asserted by the courts in a variety of contexts, and market value for assessment purposes is the value of property when put to beneficial or productive use.' (Italics added, Western Title Guaranty Co. v. County of Stanislaus, supra, 41 Cal.App.3d at p. 741.)"

The Legislature, even prior to Stanislaus, clearly recognized the previous courts' holdings on the valuation of intangibles. The aforementioned Revenue and Taxation Code section 107.7, enacted in 1988, lists numerous intangible assets or rights that might contribute to the value of a cable television system. After expressly excluding these intangible assets or rights from ad valorem property taxation, section 107.7 makes the following pertinent statement:

"However, a cable television possessory interest may be assessed and valued by assuming the presence of intangible assets or rights necessary to put the cable television possessory interest to beneficial or productive use in an operating cable television system."

Thus, the Stanislaus decision and section 107.7 provide legal reinforcement for the conclusion that the constitution requires taxable property be valued assuming the presence of whatever intangibles are necessary to put the property to beneficial and productive use.

Earnings from "Enterprise Activity" Must Not Be Considered

Herein lies the only issue involving assessment of intangibles that can objectively be considered controversial. As noted above, the court in Roehm provided that in valuing taxable property, the assessor may take into consideration "earnings" derived from the property which may depend on the presence of nontaxable, intangible rights and privileges. However, subsequent decisions have clarified that earnings derived largely from "enterprise activity" must be excluded from consideration in any valuation based on income.

Unfortunately for assessors and taxpayers, what has not been clarified is how to determine what portion of a business's income results from enterprise activity and, conversely, what portion results from attributes of the taxable property used by the business. Addressing the issue of "enterprise activity," the Stanislaus court continued:

> "With respect to the assessor's authority to consider the 'earnings' which depend upon the possession of intangible assets in valuing taxable property, the California Supreme Court has further explained: '[I]ncome derived in large part from enterprise activity [may not] be ascribed to the property being appraised; instead, it is the earnings from the [taxable] property itself or from the beneficial use thereof which are to be considered . . . . When no sound or practicable basis appears for apportionment of income as between enterprise activity and the property itself, then a method may be employed which imputes an appropriate income to the property.' (Italics added, California Portland Cement Co. v. State Bd. of Equalization (1967) 67 Cal.2d 578, 584 [63 Cal.Rptr. 5, 432 P.2d 700]; accord County of Riverside v. Palm-Ramon Development Co. (1965) 63 Cal.2d 534, 538-539 [47 Cal.Rptr. 377, 407 P.2d 289]; Madonna v. County of San Luis Obispo (1974) 39 Cal.App.3d 57, 61 [113 Cal.Rptr. 916]; ITT World Communications, Inc. v. County of Santa Clara (1980) 101 Cal.App.3d 246, 257 [162 Cal.Rptr. 186].)"

Conclusions

The foregoing discussion of legal authorities relating to the property tax treatment of intangibles leads to the following unmistakable conclusions:

- ▸Intangible personal property cannot be separately taxed.

- ▸The full value of taxable property for assessment purposes is its market value when put to beneficial or productive use.

- ▸In valuing taxable property, assessors may consider the presence of whatever intangible rights and privileges are necessary to put the property to beneficial or productive use, even though such intangibles are not themselves taxable as property.

- ▸Earnings derived <u>largely</u> from enterprise activity must not be considered in valuing taxable property. If there appears to be no basis for apportioning between earnings from enterprise activity and earnings from the taxable property itself, then some method may be used to impute an appropriate income to the property.

It is this last conclusion that has left assessors and taxpayers arguing over the value of taxable property used for business purposes. Obviously, the reason for the controversy is that the courts have stopped short of providing direction as to how to determine whether earnings are derived largely from enterprise activity, or if those same earnings result primarily from the taxable property itself. More specifically, the courts have not suggested what method(s) might be used to "impute" an appropriate level of earnings to the taxable property if there is no "sound or practicable basis" for apportioning such earnings. As indicated above, one purpose of this discussion is to shed light on possible solutions to this problem; such possible solutions are the focus of the discussions that follow.

DISTINGUISHING BETWEEN EARNINGS FROM ENTERPRISE ACTIVITY AND EARNINGS FROM PROPERTY

Analyzing the Relationship Between the Business Operation and the Property

Staff believes that to distinguish between earnings from enterprise activity and earnings from the taxable property itself, the assessor's first step should be to analyze the relationship between the activities of the business and the taxable property.

In staff's view, the critical question to be answered is whether the taxable property is an integral part of the business operation or if the property is merely incidental to the activities of the business. If the property and the business are integrally related, then the earnings of the business result primarily from attributes of the property itself. If the business and the property are incidentally related, then the earnings of the business result largely from enterprise activity.

For example, we know intuitively that in such business operations as ski resorts, golf courses, and small power producing plants, the physical (taxable) property is an integral part of the business. That is, the operators of these businesses focus on maximizing the use of the property itself. Simply, the more skiers on the slopes, the more golfers on the greens, or the more efficiently the physical plant produces power, the more profit for the business.

Certainly there is human skill involved in successfully operating these types of businesses, but the fact is that all of the human activity is ultimately directed toward making the most profitable use of the property. In a real sense, the operators of ski resorts and golf courses agree to a short-term rental of their property with each lift ticket sold or greens fee paid. For the small power plant, all of the management, technical expertise, or other human skill used in operating the plant are carried out with the aim of making the most productive, efficient use of the physical plant.

If all business operations were placed on a continuum showing the relationship between the business operation and the property used in the business, ski resorts, golf courses, and small power plants would probably be among those near the end of the continuum representing an integral relationship. Near the other end, representing an incidental relationship, might be medical or legal practices. The operators of these businesses profit not from use of their physical property but rather from the sale of human services such as medical skills or legal representation.

Criteria for Determining the Relationship Between the Business Operation and the Property

For many business operators, the relationship between earnings and property is more difficult to define than in the examples above. These businesses would fall nearer the center of our continuum. For example, a fast-food restaurant earns income for its owners by the sale of food products and service. Further, there may be an increment of its sales which would not occur without the presence of, say, a nationally-known franchise or trade name. Thus, applying the reasoning used to analyze medical and legal practices, the earnings of the restaurant would be incidental to the physical property to the extent that customers are paying for food service rather than use of the property.

However, while all of the restaurant's customers are paying for food service, many are also paying for the right to consume the food on the premises. That is, those customers that choose to eat on restaurant property are in a sense opting for a short-term rental of table space. Of course, the typical fast-food operator does not charge a premium for the right to occupy table space; dine-in and take-out customers pay the same prices for the same food items. But that only means that the take-out customers are willingly (if unwittingly) subsidizing the rental of the table space by the diners-in. The fact remains that to the extent the restaurant's earnings depend on the supply of table space, those earnings are integrally related to the use of the property.

We can probably reach only one conclusion from the foregoing discussion about the relationship between earnings and property. That conclusion is that quantifying such a relationship is a rather abstract endeavor. Thus, while we can reason that some business operators' earnings result <u>largely</u> from use of the property (e.g., ski resorts), and others <u>largely</u> from enterprise activity (e.g., medical practices), it is probably impossible to be at all precise as to the relative proportions. After all, even a medical practice has locational needs, at least generally, and location is of course an attribute of the property. Similarly, some of the earnings of a ski resort may be associated with enterprise activity.

Staff recommends assessors consider the following factors in their analysis of the relationship between the activities of the business and the taxable property used by the business.

1. Determine whether labor cost (e.g., wages, commissions, and benefits) is high or low in comparison to gross income. A high labor cost may indicate enterprise activity; a low labor cost may indicate that the business focuses on using the property itself.

2. Determine whether gross income is derived largely from the sale or rental of personal property. A high proportion of personal property sales or rentals may indicate that earnings of the business are incidental to the taxable property. A low proportion may indicate an integral relationship.

3. Determine whether the sustainable level of income is highly dependent on a brand name or the personal skill of the person or persons who are presently operating the property, or if a similar income would be expected with a different name or another knowledgeable operator. Income streams that are highly dependent on a particular brand name or on the personal skills of the present operator may be incidentally related to the taxable property.

Staff believes consideration of these factors will provide evidence as to whether a business's earnings are derived primarily from its taxable property or if such earnings result largely from enterprise activity. At the same time, because of the difficulty inherent in making precise determinations, staff has not attempted to develop specific comparisons such as "x" percentage of labor versus income indicates property income or "y" percentage indicates enterprise income.

Conclusions

Having analyzed the relationship between the activities of the business and the taxable property used by the business, the assessor will be in a position to properly relate the earnings of the business to the value of the business's taxable property.

That is, where the assessor finds a predominantly integral relationship between earnings and property, he or she should proceed in capitalizing the net income of the business in valuing the taxable property. On the other hand, where a mostly incidental relationship is found, the earnings of the business should not be utilized in valuing the business's taxable property unless the market has demonstrated a relationship between business earnings and property value.

We have already noted the difficulty inherent in determining precisely the relative proportions of earnings from enterprise activity and the taxable property. The courts seem to have acknowledged this problem as well. In California Portland, supra, the California Supreme Court stated at page 585:

> "Plaintiff's plea that it is engaged in a manufacturing business, the profits of which are not relevant to ascertainment of the 'full cash value' of . . . the property used therein . . ., presents a play on words which lacks persuasion . . . . If, as plaintiff asserts in its brief, its ultimate profits arise largely from enterprise, that fact must be given full weight by the Board in order that use of the capitalization of income method of appraisal not result in a tax on income rather than on property." (Emphasis in original.)

Where the court refers to profits arising "largely from enterprise," (emphasis added) there seems to be recognition of the difficulty with precision that we have already described. Accordingly, staff's view is that, considering the factors noted above, assessors should simply determine that a business's earnings are or are not derived "largely" from enterprise activity. Where they are, assessors should not capitalize the earnings of the business in valuing the taxable property. If the earnings are not derived "largely" from enterprise activity, it may be proper to capitalize the earnings of the business.

DETERMINING THE EXISTENCE OF INTANGIBLE PERSONAL PROPERTY

Once the assessor determines that the business's earnings are not derived largely from enterprise activity (i.e., the earnings result primarily from the taxable property), he or she may impute an income to the property, cognizant of Property Tax Rule 8(e). Rule 8(e) states in part:

> "When income from operating a property is used, sufficient income shall be excluded to provide a return on working capital and other nontaxable operating assets and to compensate for unpaid or underpaid management."

Most business property operations include a variety of "other nontaxable operating assets" that contribute to the income stream. Common examples of tangible personal property that must be excluded are licensed vehicles and inventories. The issue here, of course, is how to account for items of intangible personal property that may not be taxed.

Prior to imputing an income to a business's taxable property, the assessor's first step should be to deduct from the total consideration paid for the business's assets, or the net income derived therefrom, the value or net income attributable to any nontaxable property. This category includes items of intangible personal property since, as indicated above, these items may not be taxed separately. Thus, while recognizing that taxable property must be valued considering the presence of intangibles necessary to put the property to beneficial or productive use, assessors must be careful not to include the value of the nontaxable intangibles themselves in the value of the taxable property.

For example, in valuing the taxable property owned by a saloon, the assessor must consider the presence of the liquor license needed to operate as a saloon. At the same time, however, the assessor must take care not to assess the value of the liquor license itself, since the license is an item of intangible personal property.

Often, identifying items of intangible personal property (much less valuing them) is a nebulous undertaking. For example, is a company's customer list an item that should be identified and valued separately as an item of nontaxable intangible personal property? What about an assembled work force?

To help determine the existence of an intangible asset, the value of which must be separated from the total consideration paid for a business's assets, staff recommends applying the criteria listed below. If an item fails to meet any one of the criteria, then it need not be excluded as an item of nontaxable intangible personal property; such an item has probably become an inherent part of the tangible property.

1. The item must be identifiable; i.e., it must be legally recognized.

2. The item must be capable of private ownership.

3. The item must be marketable on its own; i.e., it must be capable of being financed or sold separate and apart from the business's tangible property.

4. The item must possess value; i.e., it must have the potential to earn income. If the item has no value, then it is of no consequence for purposes of excluding it as exempt intangible personal property.

Thus, in most cases a company's customer list need not be excluded as an item of intangible property since this item probably cannot be marketed separate and apart from the firm's tangible property. The same reasoning should be applied to an assembled workforce. At the same time, there are items that do meet the criteria and whose value must therefore be expressly excluded from the total value of the business's assets. Examples are liquor licenses and accounts receivable.

CONCLUSION

The value of taxable property in California is its value when put to beneficial or productive use. In arriving at this value, assessors are required to consider the presence of any intangible assets or rights which are necessary for the property to achieve beneficial or productive use. The value is measured by estimating the present worth of the future benefits to a prospective purchaser utilizing prudent, competent management.

In some cases, the profits of a business are merely incidental to the taxable property used by the business. This would occur where the business's earnings depend largely on personal services, the sale of inventory, or highly exceptional property management skills. In these cases, the earnings of the business are not reflective of the value of the property and should be disregarded in valuation. Further, Board Rule 8 provides that where income from operating the property <u>is</u> used (i.e., where the earnings of the business are integrally related to taxable property), income from nontaxable operating assets must be excluded.

Therefore, part of the assessor's task in estimating the value of taxable property is to determine whether sales prices and incomes indicate the value of taxable property, nontaxable property, or some combination of taxables and nontaxables. Nontaxable items include such things as liquor licenses, inventories, and insurance customer accounts; income not indicative of property value would include net income from activities such as selling merchandise and performing personal services. Taxable property includes tangible property not specifically exempted by law (e.g., inventories); income indicative of the value of taxable property would include income largely dependent on the use of the property itself.

Thus, the profits of a retail business are rarely if ever indicative of the value of the real property upon which the business is conducted; the capitalized value of such profits indicate the value of the business. But the rent paid to the landlord, presuming it represents an objective arms-length agreement between landlord and tenant, is a good indicator of value because the landlord is only in the "business" of managing the property.

The examination of a sale price or income stream may be complex or simple, depending on the nature of the property, the sale, and/or the income stream. In many cases, there appear to be so many non-property circumstances involved in a sale or income stream the assessor ignores the price and/or actual income, and uses other methods, such as the cost approach and rental incomes of comparable properties, to make the appraisal. In other cases, the assessor makes adjustments to remove nontaxable items and the remainder is used as an indicator of value for the property.

The principles of reviewing and adjusting sales and incomes for nontaxable factors have been important in the property tax assessment field for many years. From time to time, new economic circumstances, new appraisal techniques, revisions to laws and rules, and directions from the courts alter the specific methodologies used by assessors to separate nontaxables from taxable property. However, certain basic appraisal principles and mandates of law have remained consistent for many years. These principles are that a property tax assessment may not include nontaxable property, but the assessment must reflect the value recognized by the marketplace of the taxable property put to beneficial use and productive use. Such value must include whatever intangible elements that are needed to put the property to its highest and best beneficial use.

APPENDIX - SUMMARY OF KEY PROPERTY TAX DECISIONS

Purpose

The purpose of this summary is to explore leading decisions made by appellate courts on the role intangibles play in valuation for property tax purposes.

Cases Examined

Discussion of the Cases

Roehm v. County of Orange **(1948) 32 Cal.2d 280**

The Orange County Assessor made a personal property assessment (in 1946) on the plaintiff's liquor license. Plaintiff contended that taxes should not be assessed on intangibles such as ". . . liquor licenses and other licenses or on many other intangible assets such as patents, copyrights, trademarks, judgments, causes of action, the goodwill of businesses, insurance policies, stock exchange seats, press association memberships, and memberships in social, professional, and fraternal clubs." [p.281] He also contended that Section 1 of Article XIII and statutory provisions, when read in conjunction with other constitutional provisions, eliminated property taxation of all intangibles except solvent credits (excess of California accounts receivable over accounts payable--exempt since 1968).

Defendant argued that a liquor license is property within the meaning of the California Constitution and applicable statutes, and the Constitution requires all property to be taxed unless exempt. Since liquor licenses were not listed as exempt property, they are taxable for property tax purposes.

The Court found that the Constitution distinguished between tangible personal property and intangible personal property. The Constitution granted the Legislature broad power to provide for taxation of all tangible personal property, and it also provided limited power to tax specified intangible personal property (notes, debentures, shares of capital stock, bonds, solvent credits, deeds of trust, mortgages, and any legal or equitable interest therein). Since the list of intangible personal properties subject to tax was specific, all other intangible personal property is exempt except for franchises.[1]

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[1]The Constitution requires income tax on banks, and the Legislature is empowered to provide for taxation on all other franchises. The Legislature has chosen to impose income taxes on corporate franchises. With the exception of state-assessed properties, such franchises are not subject to property tax. See Section 23154 of the Revenue and Taxation Code. The Roehm court's

The court's discussion of the taxability and nontaxability of intangible personal property is very thorough and is expressed over several pages; summary quotations of a few sentences or phrases would not do justice to the court's reasoning and decision. The significant point is that the court ruled only on the taxability of intangible personal property. There was no discussion of valuation or taxability of intangible aspects of real property or tangible personal property except for two sentences at the bottom of page 285:

> "Intangible values, however, that cannot be separately taxed as property may be reflected in the valuation of taxable property. Thus, in determining the value of property, assessing authorities may take into consideration earnings derived therefrom, which may depend upon the possession of intangible rights and privileges that are not themselves regarded as a separate class of taxable property." (Emphasis added.)

The above quote seems out of place in this case, because it has nothing to do with the court's decision that intangible personal property is exempt except where the law provides for taxation of specific intangibles (solvent credits and franchises). Furthermore, there is no indication that valuation was in issue in this case. However, the quote is extremely important because it clarifies that whereas intangible personal property may not be taxed, intangible values may be reflected in the valuation of taxable property to the extent the taxable property requires possession of the intangibles. As will be seen, this quote is cited in virtually every subsequent case involving valuation and/or intangibles.

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discussion on franchises appears on pages 286; it includes references to constitutional provisions and statutes that have since been amended and/or renumbered, but the amendments do not affect the principles discussed in the decision. At the top of page 287, the court distinguished "licenses to engage in business activities" from franchises.

In staff's view, the court's statement about including intangible values should not be construed to mean that the value of a nontaxable intangible personal property item, such as a liquor license, may be included in the value of taxable property. It does mean that the assessor should not presume the absence of such intangibles when appraising the property. Thus, if the highest and best (most profitable) use of a property is a cocktail lounge, the assessor will appraise it as a cocktail lounge and not according to some alternative, less profitable use that does not require a liquor license. If a sale of the property including the license occurs, or if the assessor capitalizes an income stream that includes the license, the value of the license must be deducted from the total value to arrive at taxable property value.

Throughout the decision, the court used the terms "intangible personal property," "intangible assets," "intangible rights and privileges," and "intangibles." It is clear, however, that in all cases the court was referring only to intangible personal property items that had distinct identities and that were valuable by themselves (separate classes of property). At page 290, for example, the court mentions as examples of nontaxable intangibles life insurance policies, patents, copyrights, shares of corporate stock, and liquor licenses. The court's last mention of "intangibles," found at page 290, makes clear its interpretation that items of intangible personal property are constitutionally exempt:

> "It follows from the foregoing construction of the 1933 amendments to the Constitution and section 111 of the Revenue and Taxation Code that only the intangibles therein specified are to be regarded as personal property for purposes of taxation. [5] Liquor licenses as well as other intangible values not included in the list of intangibles specified in that constitutional provision and in section 111 are therefore not subject to ad valorem taxation as personal property."

In conclusion, the Roehm court ruled that intangible personal property assets may not be assessed except where the constitution and/or statutes authorize taxation of the specific intangible.

The court did not discuss tangible personal property or real property except for the statement at page 285 that the value of taxable property may be measured by its earnings even though such earnings may require the presence of intangible assets.

De Luz Homes, Inc. v. County of San Diego (1955) 45 Cal.2d 546

The De Luz Homes case is certainly the most far-reaching and, arguably, the most important and most quoted single case in California property tax history. The case concerned taxability of possessory interests, the definition of full cash (market) value for property tax purposes, adjustments to be made to market value in the case of possessory interests, methods of valuation, treatment of several important components (such as economic rent and depreciation) of the various methods of valuation, escape assessments, and various procedural matters. Although intangibles were not an issue in this case, the court did briefly discuss earnings from business enterprise activities. Several of the other issues are also relevant to this paper because they deal with standards of value (for property tax assessment purposes), appropriate methods of valuation, and the income approach (including the discussion on enterprise activity).

Standards of Value, at pages 561-562:

> "The standard of valuation prescribed by the Legislature is that, '[A]ll taxable property shall be assessed at its full cash value.' (Rev. & Tax. Code Sec. 401.) 'Full cash value,' as defined in section 110 of the Revenue and Taxation Code, 'means the amount at which property would be taken in payment of a just debt from a solvent debtor.' (It provides, in other words, for an assessment at the price that property would bring to its owner if it were offered for sale on an open market under conditions in which neither buyer nor seller could take advantage of the exigencies of the other. It is a measure of desirability translated into money amounts, [Citations omitted] and might be called the market value of property for use in its present condition. . . . This standard of value must be used in the assessment of all taxable property, for the Constitution of California states, 'All property in the State except as otherwise in the Constitution provided, not exempt under the laws of the United States, shall be taxed in proportion to its value, to be ascertained as provided by law, or as hereinafter provided.' (Art. XIII, Sec. 1)"

More on Standards of Value, at page 563:

> ". . . estimated value is the price it would bring if offered on an open market under conditions in which neither buyer nor seller could take advantage of the exigencies of the other, and this hypothetical market price is its value even though a sale of the property has not been made or contemplated."

Although amendments have been made both to the California Constitution and to Section 110 of the Revenue and Taxation Code subsequent to the De Luz case, the principles are still applicable to all market value appraisals, whether property tax appraisals or otherwise.

Approaches to Value, page 563-564:

> "Assessors generally estimate value by analyzing market data on sales of similar property, replacement costs, and income from the property [Citations omitted] and since no one of these methods alone can be used to estimate the value of a property, the assessor, subject to requirements of fairness and uniformity, may exercise his discretion in using one or more of them."

Income Approach, page 565:

> "In instances in which future income cannot be estimated with reasonable accuracy or is not ascribable entirely to the property, prospective net monetary income is imputed in an amount equal to a minimum reasonable return on estimated market value."

More on the Income Approach, at page 566:

> [The assessor must] ". . . estimate the price the property would bring on an open market under conditions in which neither buyer nor seller could take advantage of the exigencies of the other. The net earnings to be capitalized, therefore, are not those of the present owner of the property, but those that would be anticipated by a prospective purchaser. 'Anticipated future earning power is the sole matter of consequence, since reported earnings are already water under the mill.' (Bonbright, op. cit. supra, pl 229;

see also Babcock, op. cit. supra, pp. 229-230.) The present owner may have invested well or poorly, may have contracted to pay very high or very low rent, and may have built expensive improvements or none at all. To value property by capitalizing his anticipated net earnings would make the value of property equal to the present value of his profits; since, however, the legislative standard of value is 'full cash value,' it is clear that whatever may be the rationale of the property tax, it is not the profitableness of property to its present owner. If a purchaser would buy a given property on an open market, the property has a value equal to the price such purchaser might be expected to pay."

Following a lengthy discussion of imputed income analysis versus expected future actual net income for the subject property (pages 571- 573), the court stated at page 573:

> ". . . we do not condemn all estimates of value based on capitalization of an imputed income. In valuing property wherein actual income is derived in large part from enterprise activity and cannot be ascribed entirely to the use of the property, an imputed income analysis may be both useful and appropriate. In the present actions, however, the income from the possessory interests will be from sub-rentals and can be ascribed entirely to the possessory estates."

The De Luz case involved a 562-unit rental housing project. Although such a large project would surely involve managerial skills by the owner, the court nevertheless directed that actual projected incomes (rents) and expenses be used. The court did not suggest any allocation to nontaxable enterprise value despite its caution against using income "derived in large part from enterprise activity."

Michael Todd Co. v. County of Los Angeles **(1962) 57 Cal.App.3d 715**

This case involved the assessment of the film negatives for the movie "Around the World in Eighty Days." The assessor calculated and enrolled a depreciated cost approach appraisal of $1,526,900. The plaintiff argued that without the copyright, the negatives were not worth more than a salvage value of $1,000 and should be so assessed. The assessor's value had the effect of assessing an intangible personal property (the copyright).

Quoting the Roehm case extensively, the court found that the copyright was a distinct intangible property interest created by statute and not subject to taxation. The court agreed with plaintiff's argument that the negative could be sold separately from the copyright, and the purchaser of the negative, not having the copyright, would not be able to make any use of the negatives except as scrap ($1,000 value). Nevertheless, the court held at page 696:

> "But 'market value' for assessment purposes is the value of property when put to beneficial or productive use; it is not merely whatever residual value may remain after the property is demolished, melted down, or otherwise reduced to its constituent elements." [Citation omitted]

At page 697, the court quoted from the De Luz Homes case in discussing the three approaches to value (sales, cost, and income) used by assessors and that ". . . the assessor, subject to requirements of fairness and uniformity, may exercise his discretion in using one or more of them." In this case, the assessor calculated two cost approaches to arrive at the $1.5 million value, and the court approved the assessor's approaches as being reasonable for the situation at hand.

It has been argued that the film, including copyright, negatives, and prints, may have been worth as much as $20 million. By approving the assessor's cost approach, the court rejected income or sales approaches that would have included the value of the copyright or that could been characterized as enterprise value appraisals.

Speculation on what the court would have done under different circumstances is flimflammery. The court was presented two choices--a scrap value and a cost approach value. The court approved the cost approach value, even though that value assumed the presence of an exempt intangible property. The viability of an income or sales approach for the negatives was not at issue and was not discussed by the court.

County of Riverside v. Palm-Ramon Dev. Co. **(1965) 63 Cal.2d 534**

The assessor used an imputed income approach to appraise the possessory interests of the appellant. The assessor's approach consisted of estimating the fee value of land ". . . in accordance with his usual methods of valuing fees" (at page 537), reducing the fee value by the present value of the reversion, and estimating the improvements values by the cost approach. The assessor's appraisals and methodologies were upheld by the county board of equalization and affirmed by the trial court. The taxpayer contended the assessor should have used an "actual" income approach as directed by the court in the De Luz Homes case.

The court approved the assessor's use of an imputed income instead of actual income. At pages 538-539:

> "Here it appears that the actual income will be derived largely from enterprise activity (development, subleasing, percentage renting for commercial or professional usage). Further, the assessor found a method which approximated the 'imputed income' method to be both useful and appropriate in view of his determination that there was a lack of actual income and expense history, and no error is shown."

The above text could be taken to mean that Palm-Ramon's income from such things as development, subleasing, and percentage leasing are enterprise incomes that are improper for use in a property tax appraisal. However, the question was not decided because (at pages 537-538) ". . . defendants failed to produce for the use of the assessor or at the hearings before the board of equalization actual income and expense figures which could be used for the purpose of a reliable capitalization of income method of appraisal." And at page 539: "The trial court, as stated, found that defendants had failed to produce any such [actual income and expense] history for the use of the assessor or the board of equalization . . . ."

Thus, while the Palm-Ramon court affirmed that income "derived largely from enterprise activity" is inappropriate to use for property tax appraisals, the taxpayer's failure to provide data made it impossible for the court to make a ruling on a method employing the taxpayers's actual income.

California Portland Cement Co. v. State Board of Equalization
(1967) 67 Cal.2d 578

The plaintiff's property (a limestone quarry and adjacent cement mill) was selected by the Board as part of an appraisal sample of the Kern County assessment roll. The plaintiff made some data available to the Board appraiser but refused to provide information relating to sales volumes and income, costs of production, and production volume. Plaintiff contended that the data would be useful only to value the <u>business</u> in the hands of the owner and not the <u>property</u>. The court disagreed and held that the information sought by the Board was relevant.

The court recited that there are three basic approaches to value (sales, income, and cost); the Board did not have sufficient data to use the comparable sales approach, the income approach is the primary method used by the Board for valuing petroleum and mining properties, and the cost approach was not discussed.

After pointing out that the income approach is a well-accepted tool for valuing property, the court issued numerous cautions against improper use of the income approach. At page 584:

> "However, when earnings are taken into account or the capitalization of income method is employed, the profitableness of property to its present owner does not provide a standard by which to arrive at its 'full cash value'; rather, the net earnings to be considered or capitalized are those that would be anticipated by a prospective purchaser. Nor may income derived <u>in large part</u> from enterprise activity be ascribed to the property being appraised; instead, it is the earnings from the property itself or from the beneficial use thereof which are to be considered. When no sound or practicable basis appears for apportionment of income as between enterprise activity and the property itself, then a method may be employed which imputes an appropriate income to the property." [Citations omitted.] (Emphasis added.)

Despite the cautions, the court approved the use of the income method, at page 585:

> "Plaintiff's plea that it is engaged in a manufacturing business, the profits of which are not relevant to ascertainment of the 'full cash value' of a part of the property used therein (apparently plaintiff refers to the cement mill only), present a play on words which lacks persuasion. The taxpayers whose property has been valued by the capitalization of income method, as in De Luz, Palm-Ramon, El Tejon, etc., may likewise be viewed as engaging in the 'business' of using, managing or developing the property or its products, hopefully for a profit. Plaintiff's quarry and cement mill, together comprising the Mojave Plant, appear to be operated as a unit, with each contributing to the economy of the other. [7b] If, as plaintiff asserts in its brief, its ultimate profits arise largely from enterprise, that fact must be given full weight by the Board in order that use of the capitalization of income method of appraisal not result in a tax on income rather than on property."

The California Portland case is significant because the court approved the concept of using an income approach to appraise a property that was not rented. The income and expenses would result from the owner's use, management, and development of the property.

At the same time, the court cautioned against capitalizing enterprise profits and repeated the suggestion from the De Luz case that ". . . a method may be employed which imputes an appropriate income to the property." Unfortunately, no court has suggested what "method" would or would not be acceptable.

***Madonna v. County of San Luis Obispo* (1974) 39 Cal.App.3d 57**

This case involved the valuation of the improvements portion of the Madonna Inn in San Luis Obispo County. The assessor calculated an income estimate of $3.5 million and a cost approach estimate of $1.5 million. The taxpayer provided a cost approach estimate of $1.0 million. The county board of equalization found that the assessor's income approach improperly included enterprise income (Board Findings 2, 3, and 4). The board made no specific adjustments to the income approach and concluded a value of $2.5 million.

The court held that since the county board had ruled that the income approach was erroneous and did not correct it, the board was left with only the two cost approach value indicators. Since those indicators were $1.0 and $1.5 million, the board's value conclusion of $2.5 million did not fall within any acceptable range of cognizable evidence.

This case is often cited inappropriately as an example of an appellate court's disapproval of an income approach valuation that includes enterprise income. But it was the county board of equalization, not the court, that found the assessor's income approach was defective. Those findings were not challenged before the court, and the court made no ruling on whether the assessor's income approach was or was not proper.

***Western Title Guaranty Co. v. County of Stanislaus* (1974) 41 Cal.App.3d 733**

This case involved the assessment of a "title plant" which consisted of an accumulation of title records gathered and assembled by the plaintiff. The assessor used the cost approach to value. There were no known comparable sales available, and the income approach was not discussed in the case. The plaintiff argued (at page 737) that ". . . the assessments 'were illegal and void by reason of the fact that the said title plant is intangible personal property and therefore not subject to taxation . . . .'"

The court relied extensively on the Roehm and Todd cases in finding that the assessment was proper. At page 738, the court stated:

> [The Todd court] ". . . determined that assessing authorities may take into consideration earnings derived from intangible rights and privileges that are not themselves regarded as a separate class of taxable property and thus be reflected in the valuation of the taxable property. If we apply the principle of production value or earning value to the information contained in appellant's title records upon which it bases an opinion as to the condition of the title of a parcel of real property, which opinion supports the issuance of title insurance, we see little difference between this case and the Todd case."

Since the court in both Todd and this case found a cost approach was proper, the cable television industry has argued that the courts are suggesting that the cost approach is the only proper approach to use when nontaxable intangibles may be present. There is nothing in Western Title to suggest such a conclusion. As stated above, there were no comparable sales available; the court did not comment on whether a sales approach would be correct. There was also no discussion of an income approach, but the court repeatedly mentioned the propriety of considering "earnings" from the property, including citations from Roehm and Todd on earnings as well as the first sentence of the above citation. Thus, although the case did not involve an income approach, the court clearly supported the proposition that earnings from a property are an appropriate measure of taxable value, even though the earnings may depend on the presence of intangibles.

ITT World Communications, Inc. v. County of Santa Clara
(1980) 101 Cal.App.3d 246

This case involved a state-assessed property where the Board-adopted values were based primarily on the income (capitalized earnings) approach and were substantially higher than the cost approach indicators. In addition to some procedural arguments, ITT argued that its property could not lawfully be assessed higher than RCNLD (reproduction cost new less depreciation); that a value in excess of RCNLD is necessarily a tax upon its franchise, which is exempt; that RCNLD is a natural upper limit on the value of tangible property because no one would pay more for something than the cost to replace it; and that the Board erroneously failed to make necessary deductions of income attributable to enterprise activity.

The court agreed that intangible personal property is exempt from property taxation. At page 251:

> ". . . corporate franchises of public utilities, excepting special franchises, are excluded from property taxation . . . . All other forms of intangible personal property are also exempt from property taxation."

However, the court found at page 254:

> "While intangible property is exempted from property taxation, such property may enhance the value of taxable tangible property, and this effect may be reflected in the valuation of the tangible property."

The court went on to cite <u>Roehm</u>, <u>Michael Todd</u>, and <u>Western Title</u> in stating:

> "'[T]he propriety of including non-taxable intangible values in the valuation of otherwise taxable property has been asserted by the courts in a variety of contexts, and market value for assessment purposes is the value of property when put to beneficial or productive use.' Although appellant's franchise cannot be assessed and directly subjected to property taxation, the assessment of its taxable property may take into account earnings from that property that depend upon appellant's possession of a franchise. <u>Such an assessment</u>

> would properly reflect the effect of the intangible value of possession of the franchise on the value of the tangible, taxable property." (Emphasis added.)

The court also found that the cost approach is not the upper limit of value. At page 256:

> "It cannot be said that, as an absolute rule of appraisal practice, and as an intrinsic attribute of tangible property, RCNLD is a ceiling on value. Thus it cannot be said that, as a matter of law, an assessment in excess of RCNLD is necessarily arbitrary, in excess of discretion, or in violation of standards prescribed by law."

This case affirmed the position taken by many previous courts, that taxable, tangible property may be valued by using an income approach. The case broke new ground in finding that an assessment based on earnings may properly reflect the effect of intangibles and that reproduction cost new less depreciation is not the upper limit of value.

Cox Cable San Diego, Inc. v. County of San Diego
(1986) 185 Cal.App.3d 368

The primary issue in this case was whether the rights to use and occupy public rights-of-way for the purpose of operating a cable television franchise constituted a possessory interest. Of interest here is the court's discussion of franchises. As the Roehm case pointed out, franchises are a separate class of property that, except for special franchises assessed by the State Board of Equalization, are not subject to property tax assessment. At page 385:

> "We next consider Cox's argument its use and possession is not separable from the franchise itself and for this reason is not taxable as a possessory interest. It is true franchises are a class of property separate from all classes of property and are made a separate subject of taxation by section 27 (formerly section 16) of article XIII of the California Constitution. (Roehm v. County of Orange (1948) 32 Cal.2d 280, 286 [196 P.2d 550])"

At page 386:

> "The view that there is a merger of any possessory interest held by a franchise itself for purposes of taxation simply is not supported by authority. In Stockton Gas etc. Co. v. San Joaquin Co., supra, 148 Cal.313, 321, discussing the issue of where property must be assessed under the constitutional requirement that property be assessed where it is situated, the court did say the similar franchise 'is indissolubly annexed to the street of a city in and upon which it is exercised . . . an easement appurtenant to such streets. This being so, it necessarily, as real property, has a situs in the city where it is exercised, and, under the constitutional provision with reference to the assessment of property, must be assessed." [Underlined words are italicized in the original.]

Thus, the court distinguished between franchises that are a separate class of intangible personal property (Roehm) that are not taxable by the assessor and franchises that are "indissolubly annexed" to real property and therefore are taxable. The court went on to distinguish between general franchises of state-assessed properties that are assessable by the Board and special franchises that are assessable regardless of whether the assessment is made by the Board or by the assessor.

County of Stanislaus v. County of Stanislaus Assessment Appeals Board and Post-Newsweek Cable, Inc. **(1989) 213 Cal.App.3d 1445**

This case involved the assessability of a cable television possessory interest and the assessability of intangible rights. The assessments were based primarily upon the sale price of the system and did not specifically identify a possessory interest as part of the value. At the appeals board level, the assessor argued that the assessment was justified because the tangible assets were enhanced by the presence of the franchises. The taxpayer argued that the cable television franchises were exempt intangible assets, and prevailed at the appeals board and superior court levels.

When the case reached the appellate court level, the Cox case had been decided. The county argued the entire cable television franchise, including but not limited to the possessory interest, is taxable property. The taxpayer (Post-Newsweek Cable) argued (1) that the Cox case was decided incorrectly because the cable television franchises are nonexclusive--the court quickly disposed of the argument and affirmed Cox--and (2) if there is a possessory interest, all parts of the franchise except for the possessory interest are nontaxable intangible property.

At page 1452, the court found that cable television franchises ". . . consist of two basic components: the right to use the public streets to lay the cables and the right to charge a fee to subscribers for their use of the cable facilities." The court went on to explain that the first component is an assessable possessory interest, but the "intangible right to do business is not assessable" for property tax purposes (page 1454).

The court then cited Roehm, Michael Todd, Western Title, California Portland Cement, and other cases to reassert the propriety of valuing taxable property as though put to beneficial use even though such beneficial use requires the presence of nontaxable intangibles. The court also cautioned against using income from enterprise activity, stating at page 1455:

> "When no sound or practicable basis appears for apportionment of income as between enterprise activity and the property itself, then a method may be employed which imputes an appropriate income to the property."

At page 1456, the court concluded:

> "In valuing Post-Newsweek's possessory interest on remand, the assessor shall consider the intangible right to do business as required by the above authorities. In so doing, the assessor may impute to the possessory interest an 'appropriate' income from the right to engage in business."

The Stanislaus court's statements on the use of enterprise income are totally consistent with the De Luz and California Portland cases in stating that "a method" may be used to distinguish enterprise income from property income. As is true with the other cases, the court did not specify what "method" would or would not be acceptable.